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In the Supreme Court of the United States

OCTOBER TERM, 1958

EUGENE J. ARNFELD AND HENRY J. MOSES, EXECUTORS OF THE ESTATE OF ANDREW WINEMAN, DECEASED, AND EUGENE J. ARNFELD AND MORTIMER H. MEYER, SUCCESSOR EXECUTORS OF THE ESTATE OF ELSA WINEMAN, DECEASED, PETITIONERS

v.

THE UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR THE UNITED STATES IN OPPOSITION

J. LEE RANKIN,
Solicitor General,
CHARLES K. RICE,
Assistant Attorney General,
I. HENRY KUTZ,
MYRON C. BAUM,
Attorneys,
Department of Justice, Washington 25, D.C.

INDEX

	Page
Opinion below	1
Jurisdiction	1
Question presented	2
Statutes involved	3
Statement	4
Argument	8
Conclusion	15

CITATIONS

Cases:	
Bell's Estate v. *Commissioner*, 137 F. 2d 454	14
Blair v. *Commissioner*, 300 U.S. 5	14, 15
Bodine v. *Commissioner*, 103 F. 2d 982, certiorari denied, 308 U.S. 576	8
Cobbs v. *Commissioner*, 39 B.T.A. 642, appeal dismissed, 111 F. 2d 644	8
Commissioner v. *P. G. Lake, Inc.*, 356 U.S. 260	7, 9, 10, 11
Corn Products Co. v. *Commissioner*, 350 U.S. 46	11
Doyle v. *Commissioner*, 147 F. 2d 769	12, 13
Fisher v. *Commissioner*, 209 F. 2d 513	12
Harrison v. *Schaffner*, 312 U.S. 579	14
Helvering v. *Horst*, 311 U.S. 112	10
Helvering v. *Smith*, 90 F. 2d 590	11
Home Furniture Co. v. *Commissioner*, 168 F. 2d 312	13
Hort v. *Commissioner*, 313 U.S. 28	12
Lasky v. *Commissioner*, 22 T.C. 13, appeal dismissed, 235 F. 2d 97, affirmed, 352 U.S. 1027	12
McAllister v. *Commissioner*, 157 F. 2d 235	14
Phillips v. *Commissioner*, 30 T.C. 866	13
Rhodes' Estate v. *Commissioner*, 131 F. 2d 50	12
Sorensen v. *Commissioner* 22 T.C. 321	12
Trousdale v. *Commissioner*, 219 F. 2d 563	11
United States v. *Shafto*, 246 F. 2d 338	13
United States v. *Snow*, 223 F. 2d 103	11

498362—59

Statutes:

	Page
Internal Revenue Code of 1939:	
Sec. 22(b). (26 U.S.C. 1952 ed., Sec. 22(b))	3, 8
Sec. 117(a) (26 U.S.C. 1952 ed., Sec. 117(a))	3
Sec. 117(b) (26 U.S.C. 1952 ed., Sec. 117(b))	4
Miscellaneous:	
G. C. M. 18233 1937–1 Cum. Bull. 147	8

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OPINION BELOW

The opinion of the Court of Claims (Pet. App. 1a–11a) is reported at 163 F. Supp. 865.

JURISDICTION

The judgment of the Court of Claims was entered on July 16, 1958. (Pet. App. 1a.) A timely petition for rehearing was denied on October 8, 1958. (R. 33.) The petition for a writ of certiorari was filed on January 5, 1959. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1255(1).

QUESTION PRESENTED

Taxpayers[1] purchased an optional deferred income policy in 1939 under which they were entitled to deposit with the insurance company amounts up to $100,000 and were entitled to receive upon maturity on January 6, 1951, either the cash value of the policy or an annuity. Taxpayers deposited a total of $81,000 with the insurance company. The cash value of the policy on January 6, 1951, was $117,330.14, consisting of the amounts deposited plus 3½% interest compounded annually. On January 3, 1951, three days prior to maturity, taxpayers sold the policy to an independent insurance agent for $117,000. Funds for this purchase were advanced by a bank which received the policy as collateral. On the following day, the bank surrendered the policy for its cash value and received $117,330.14.

The question presented is whether the sale of the policy under the circumstances described was merely a transfer of the right to receive ordinary income, in the form of accrued interest on the amount deposited, as the court below held, or constituted a sale or exchange of a capital asset, as taxpayers contend.

---

[1] The policy in question was purchased by Andrew Wineman who assigned it to his wife, Elsa Wineman, five days later. The proceeds of the policy received in 1951 were reported by them in a joint tax return filed by them for that year. The present petitioners are the executors of the estates of Andrew and Elsa Wineman who died after the occurrence of the events here in controversy. Consequently, the deceased taxpayers will be referred to as the taxpayers herein.

STATUTES INVOLVED

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

* * * * * *

(b) *Exclusions from Gross Income.*—The following items shall not be included in gross income and shall be exempt from taxation under this chapter:

* * * * * *

(2) [as amended by Sec. 120(d), Revenue Act of 1942, c. 619, 56 Stat. 798] *Annuities, etc.*—

(A) *In general.*—Amounts received (other than amounts paid by reason of the death of the insured and interest payments on such amounts and other than amounts received as annuities) under a life insurance or endowment contract, but if such amounts (when added to amounts received before the taxable year under such contract) exceed the aggregate premiums or consideration paid (whether or not paid during the taxable year) then the excess shall be included in gross income.

* * * * * *

(26 U.S.C. 1952 ed., Sec. 22)

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *Definitions.*—As used in this chapter—

(1) [as amended by Sec. 210(a), Revenue Act of 1950, c. 994, 64 Stat. 906] *Capital assets.*—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include—

* * * * * *

(4) [as amended by Sec. 150(a)(1), Revenue

Act of 1942, *supra.*] *Long-term capital gain.*—The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such gain is taken into account in computing gross income; '

* * * * *

(b) [as amended by Sec. 150(c), Revenue Act of 1942, *supra*]. *Percentage taken into account.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net capital gain, net capital loss, and net income:

100 per centum if the capital asset has been held for not more than 6 months.

50 percentum if the capital asset has been held for more than 6 months.

(26 U.S.C. 1952 ed., Sec. 117)

STATEMENT

This action involves claims for refund of income taxes and interest paid for the year 1951 in the amount of $25,494.25. (Pet. App. 1a, 17a.)

On January 6, 1933, taxpayer Andrew Wineman purchased from the Penn Mutual Life Insurance Company an 18-year optional deferred income policy to mature when the insured reached the age of 70. The policy contained a variable deposit provision permitting the insured or his assignees to make deposits at any time not in excess of an aggregate of $100,000, unless that limit was waived by the Company, and was to mature on January 6, 1951. On January 11, 1933, taxpayer Andrew Wineman assigned the policy

to his wife, taxpayer Elsa Wineman. (Pet. App. 1a–2a, 12a.) At the time he acquired the policy, Andrew Wineman made an initial deposit of $10,000. Thereafter, additional deposits were made from time to time by Elsa Wineman, the last such deposit having been made on March 4, 1949. The total deposits amounted to $81,000, which was the cost basis of the policy at the time of the events here in question. (Pet. App. 4a, 12a, 16a.)

Andrew Wineman had purchased the policy from one Kaichen, who was a general agent for the Penn Mutual Life Insurance Company until 1941. The policy was offered by this insurance company, as well as other companies, as a conservative investment to meet the needs of persons who had suffered a decline in the value of their investments during the depression years. After the war, however, such contracts became less attractive investments and Andrew Wineman criticized Kaichen for having induced him to make a poor investment. Kaichen thereupon suggested that taxpayers sell the policy and use the proceeds to acquire common stock or other more profitable securities. Kaichen suggested a sale, rather than surrender of the policy for its cash surrender value, because he believed that an income tax saving could be realized thereby. This belief was confirmed by taxpayers' accountants. (Pet. App. 2a–3a, 12a–13a.)

The cash surrender value of the policy was $117,330.14. (Pet. App. 3a, 15a.) Kaichen suggested that the policy be sold to the National Bank of Detroit; he had no thought of purchasing the policy personally. Accordingly, Andrew Wineman and Kaichen

went to the bank on January 3, 1951, but they were informed that the bank could not legally make such a purchase. The vice president of the bank suggested, however, that Kaichen buy the policy and that the bank would lend $117,000, the agreed selling price of the contract, on Kaichen's personal note with the policy attached as collateral. (Pet. App. 13a–14a.) When Andrew Wineman became aware of the fact that the cash surrender value of the contract was slightly in excess of $117,000, and that Kaichen was making a profit of $240.77 on the transaction, he raised some objection. He waived his objection, however, upon being informed by the vice president of the bank that Kaichen was entitled to a profit for his part in disposing of the contract. (Pet. App. 13a–16a.).

Accordingly, on January 3, 1951, taxpayer Elsa Wineman transferred the policy to Kaichen for the agreed price of $117,000. This amount was borrowed from the bank with the policy pledged as collateral. On the following day January 4, 1951, the bank mailed the policy to the Penn Mutual Life Insurance Company together with a letter requesting that the cash surrender value be remitted to the bank. On January 5, 1951, Kaichen paid taxpayer Elsa Wineman $117,000, the purchase price of the policy. The cash surrender value in the amount of $117,330.14 was received by the bank on January 15, 1951, and was applied by it in payment of the loan and accrued interest thereon. The balance of $240.77 was credited to Kaichen's account. (Pet. App. 3a–4a, 14a–15a.)

According to the provisions of the policy concerning

income payments, death benefits, and cash values, the amounts deposited under the policy accumulated at 3½ percent interest compounded annually during the life of the contract. The rate of return of the contract was thus fixed. (Pet. App. 8a, 16a.)

Taxpayers filed a joint income tax return for the year 1951 in which the sum of $36,000, the difference between the cost of the policy, $81,000, and the amount received, $117,000, was reported as a capital gain. Thereafter the Commissioner of Internal Revenue determined that such gain constituted ordinary income and asserted a deficiency against taxpayers in the amount of $23,137.23 plus interest. This amount was subsequently paid. Claims for refund having been filed by taxpayers and rejected by the Commissioner, this suit followed. (Pet. App. 4a, 16a–17a.)

The Court of Claims rejected the Government's contention that the transfer of the policy did not constitute a bona fide sale or exchange, but found that the cash surrender value consisted of the amounts deposited together with accrued interest thereon. It therefore upheld the Government in its alternative contention that the transfer represented nothing more than a transfer of the right to ordinary income rather than a sale or exchange of a capital asset. Since taxpayers would have realized ordinary income if they had surrendered the policy to the insurance company instead of transferring it to Kaichen shortly before maturity, the Court of Claims was of the view that the transaction in question was merely an attempt to convert ordinary income into capital gain, a practice disapproved in *Commissioner* v. *P. G. Lake, Inc.*,

498363—59—2

356 U.S. 260, and other cases cited in the court's opinion.

ARGUMENT

The issue presented by this case involves nothing more than the question as to whether a right to receive ordinary income can be transformed into a capital gain merely by the transfer of the contract under which the right to ordinary income had accrued. The holding below that such a transfer of a right to ordinary income does not constitute the conversion of a capital asset is correct and is not in conflict with any decisions of this Court or of any court of appeals.

1. Under Section 22(b)(2) of the Internal Revenue Code of 1939, *supra* (p. 3), amounts received under life insurance or endowment policies or contracts are income to the extent of the excess of the amount received over the consideration paid. Such amounts are taxable as ordinary income whether received upon maturity of the policy or contract or upon surrender thereof for its cash surrender value. *Bodine* v. *Commissioner*, 103 F. 2d 982 (C.A. 3d), certiorari denied, 308 U.S. 576; *Cobbs* v. *Commissioner*, 39 B.T.A. 642, appeal dismissed, 111 F. 2d 644 (C.A. 9th); G.C.M. 18233 1937-1 Cum. Bull. 147. The contract here in question does not call for the application of any different rule. Although labeled a deferred income policy and providing for the payment of an annuity upon maturity, the policy nonetheless provided that it could be surrendered at the end of any policy year for its then cash value. It could also be surrendered upon maturity and prior to the commencement of

annuity payments as was in fact done in the present case. It was not a policy calling for the payment of premiums as they are commonly known in insurance contracts. Instead, it provided for deposits at the option of the insured up to a total of $100,000. These deposits whenever made, as the court below found, accumulated at 3½ percent compounded annually. (Pet. App. 8a, 16a.) The policy was, therefore, simply one which, at the option of the insured or his assignees, could be surrendered for an amount equal to the total deposits made thereunder plus interest thereon compounded at 3½ percent. As such, it represented a right to the return of the investment together with the accrued ordinary interest income thereon.

This Court has recently held in *Commissioner* v. *P. G. Lake, Inc.*, 356 U.S. 260, that a right to ordinary income may not be transformed into the conversion of a capital investment merely by the sale of a property right which represents nothing more than a right to ordinary income. Similarly, here, taxpayers may not transform their right to ordinary income into the sale or exchange of a capital asset merely by the sale of the insurance contract three days before maturity, where the value of such contract can be measured simply by the original investment together with the ordinary income accrued thereon. As this Court stated in *Lake, supra* (p. 265), "the lump sum consideration seems essentially a substitute for what would otherwise be received at a future time as ordinary income." And the consideration represents the value of the obtainable

income, not the increase in value of income-producing property. The future time referred to in *Lake* was a period of years thereafter; in the present case it was a matter of only a few days.

Taxpayers seek to distinguish the *Lake* decision upon the ground that it involved only a three year assignment of income from oil property. (Pet. 7.) This asserted distinction is, however, without merit. The oil payment rights involved in *Lake* were considered by this Court to be, in themselves, property interests. They were not assigned for a limited period, but would have become extinguished by their terms after a calculable period. Similarly here, the property interest would likewise be extinguished after a calculable period, namely the maturity of the policy three days after the transaction in question. In actual fact, the interest was extinguished on the following day when the purchasers surrendered the policy for its cash value. The instant facts, therefore, represent an *a fortiori* situation to that presented in *Lake, supra,* since here the transaction did not even carry with it the gloss of the sale of a property right for some seemingly indefinite future time. The substance of the transaction in *Lake* was held to be an assignment of the right to receive income; the substance of the present transaction is the same, for the facts demonstrate that the assignment was nothing more than an assignment for the purpose of immediate collection of interest income plus the amounts deposited. The principles enunciated by this Court in *Helvering* v. *Horst,* 311 U.S. 112 are therefore applicable.

This Court also held, in *Corn Products Co.* v. *Commissioner*, 350 U.S. 46, that the term "capital assets", as used in the Internal Revenue Code of 1939, must be narrowly construed and that the preferential treatment accorded capital gains was intended to relieve taxpayers from excessive tax burdens on the conversion of capital investments. Such burdens do not exist here, for the tax sought to be imposed is the tax which would have been applicable had no transfer of the policy been made. Taxpayers are merely seeking to avoid the tax consequences of the maturity of the policy by casting the transaction in the form of a sale. As this Court noted in *Lake*, however, such a "sale" is merely a substitution for what would otherwise be receivable as ordinary income.

As the court below properly noted, this problem has received consideration in a variety of contexts. It has frequently arisen in connection with the sale of partnership interests, and it has there been held that where the sale of a partnership interest carries with it the right to ordinary income previously earned, the transaction must be treated as the realization of ordinary income to the extent that the sale price reflects a transfer of the right to such income. *Helvering* v. *Smith*, 90 F. 2d 590 (C.A. 2d); *United States* v. *Snow*, 223 F. 2d 103 (C.A. 9th); *Trousdale* v. *Commissioner*, 219 F. 2d 563 (C.A. 9th). The applicable principles were well stated by the Court of Appeals for the Ninth Circuit in *United States* v. *Snow*, *supra*, as follows (p, 108):

> However, it is not decisive of the issue here presented to find that the subject matter prop-

> erly bears the capital asset label. It is a fundamental principle of federal tax law that you must regard any ordinary income derived from an income-producing capital asset as ordinary income. Consequently, the assignment of accrued ordinary income must be treated separately from the assignment of the capital asset which produced the income. * * *
>
> The general rule is that a right to receive ordinary income, produced by a capital asset, is not transmuted into a capital asset by the sale or assignment of the capital asset together with the right to receive the ordinary income. * * *

In *Hort* v. *Commissioner*, 313 U.S. 28, this Court held that the consideration received by a lessor for the cancellation of a lease was merely a substitute for what would otherwise have been ordinary income and did not represent the sale or exchange of a capital asset which could result in capital gain. Likewise, capital gain treatment has been denied upon the transfer of a right to declared dividends (*Rhodes' Estate* v. *Commissioner*, 131 F. 2d 50 (C.A. 6th)); to the transfer of a note with accrued income thereon (*Fisher* v. *Commissioner*, 209 F. 2d 513 (C.A. 6th)); to the transfer of an interest in a judgment (*Doyle* v. *Commissioner*, 147 F. 2d 769 (C.A. 4th)); to the transfer of stock options received as compensation (*Sorensen* v. *Commissioner*, 22 T.C. 321), and to the transfer of a right to accrued royalties (*Lasky* v. *Commissioner*, 22 T.C. 13, appeal dismissed, 235 F. 2d 97 (C.A. 9th), affirmed, 352 U.S. 1027). In all of these cases, as in the present case, the courts have

found that the property right transferred represented nothing more than the right to ordinary income. The transfer of such a right, as has been uniformly held, cannot be transformed into capital gain merely by the transfer of an interest in property pursuant to which the right to ordinary income accrues.

Taxpayers refer to the decision of the Tax Court in *Phillips* v. *Commissioner*, 30 T.C. 866, now pending on appeal to the Court of Appeals for the Fourth Circuit. Although that case involved the transfer of a single premium endowment policy some twelve days before maturity, the decision of the Tax Court is distinguishable. The Tax Court held only that the increment realizable on the particular policy before it did not represent interest income, but that it represented, among other things, excess premium charges resulting from more favorable insurance experience than contemplated by its actuarial computations. The Tax Court, in that case, did not decide whether the excess of the proceeds of the endowment policy over the premiums there paid constituted ordinary income, and it did not decide whether the sale of the policy therefore represented a transfer of the right to receive such income. Moreover, in view of the decisions by the Fourth Circuit in *Doyle* v. *Commissioner, supra; Home Furniture Co.* v. *Commissioner*, 168 F. 2d 312; and *United States* v. *Shafto*, 246 F. 2d 338, involving respectively a transfer of an interest in a judgment, a transfer of an interest in accounts receivable, and an assignment of leases by the lessor, the decision in *Phillips* appears incorrect if you assume that interest income is involved.

In all of these cases, the Fourth Circuit held that the substance of the transaction amounted to the transfer of a right to receive ordinary income.

2. Taxpayers also assert (Pet. 3–4) that the decision below is in conflict with the decisions in *Blair* v. *Commissioner*, 300 U.S. 5; *McAllister* v. *Commissioner*, 157 F. 2d 235 (C.A. 2d); and *Bell's Estate* v. *Commissioner*, 137 F. 2d 454 (C.A. 8th). All of these cases involved transfers of interests in life estates. The distinction between the holding in *Blair* and the rationale of the cases here relied upon was explicitly recognized by this Court in *Harrison* v. *Schaffner*, 312 U.S. 579, where this Court stated (p. 583): "Nor are we troubled by the logical difficulties of drawing the line between a gift of an equitable interest in property for life effected by a gift for life of a share of the income of the trust and the gift of the income or a part of it for the period of a year as in this case." The same distinction was recognized by the Court of Appeals for the Second Circuit in *McAllister* v. *Commissioner*, *supra*, in which the foregoing language was quoted (p. 237) and the court stated in addition (p. 237): "The distinction seems logically and practically to turn upon anticipation of income payments over a reasonably short period of time and an out-and-out transfer of a substantial and durable property interest, such as a life estate at least is." Similarly, in *Bell's Estate*, *supra*, the Court of Appeals for the Eighth Circuit drew a distinction between the transfer of an interest in a life estate and a transfer of a right to income.

The distinction thus judicially recognized is fully applicable here. We are not confronted with a transfer of a right to income for a period of years or even for a period of one year. What we have here is the transfer of the right to income for a period of one day for purposes of collection. Surely, this cannot be equated to the transfer of an equitable interest in a life estate carrying with it the equitable ownership of property for the indefinite future. Neither this Court nor the Courts of Appeals have attempted to extend the doctrine of *Blair* to the transfer of interests which were merely a substitute for the right to receive ordinary income, nor should such an extension be made here.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

J. LEE RANKIN,
Solicitor General.

CHARLES K. RICE,
Assistant Attorney General.

I. HENRY KUTZ,
MYRON C. BAUM,
Attorneys.

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